Baltic Horizon Fund 'MM3' Rating Affirmed And Off CreditWatch Based On COVID-19 Resilience

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- Baltic Horizon Fund (BHF)'s 2020 operating and financial performances will be hit by a decline in retail rental income and asset valuations following the coronavirus outbreak
- We expect tight headroom for BHF's credit metrics but that interest coverage will stay higher than 2.4x and the loan-to-value (LTV) ratio below 60% on average for 2020-2021.
- BHF benefits from good portfolio diversification, high-quality tenants, and limited COVID-19 disruption in the Baltics, which should enable the company to maintain adequate liquidity and metrics in line with the current rating
- We are therefore affirming our 'MM3' mid-market evaluation ratings on BHF and its €50 million unsecured notes due in 2023 and removing them from CreditWatch negative, where we placed them on May 7, 2020. Recovery prospects on the notes remain 30%-70%.

LONDON (S&P Global Ratings) July 27, 2020--S&P Global Ratings today took the rating actions listed above.

BHF's operating performance shows a sufficient degree of resilience against the COVID-19 pandemic. The real estate sector is facing a challenging 2020 since COVID-19 containment measures has caused a contraction of global demand. So far, Baltic countries have reported a lower number of COVID-19 cases than western and other Nordic European countries. Furthermore, governments have been gradually lifting COVID-19-related restrictions. For BHF, the retail and leisure segments were hit harder in the second quarter than the office segment. We estimate unpaid rent will reduce cash flow by no higher than 4% for office space in March, April, and May on a cumulative basis, and 20% for the leisure and retail segments. Within these figures, around 8% of total rents were merely deferred and are expected to be collected by the end of the third quarter. Retail and leisure tenants account for about 50% of the company's rental income. These tenants have been affected most by government-imposed business closures and social-distancing measures. Although the negative impact of pandemic containment has been partly mitigated by government support to landlords and tenants, vacancy rates have slightly increased in the Galerija and Europa shopping centers after small tenants left. We still believe the pandemic could severely hamper the global retail sector, which was already experiencing intense competition from e-commerce and changes in consumer behavior. Moreover, we expect a rise in unemployment rates due to COVID-19 will further pressure disposable income and retail sales. On the other hand, the company has experienced limited disruption in the office segment. Although many office tenants have implemented work-from-home policies, BHF benefits from a solid tenant base consisting of well-established international companies and public-sector bodies. We also recognize BHF's management and governance has been receptive and proactive in adapting its financial and operational strategy to the unexpected disruption, implementing a more conservative dividend policy and offering discounts and rent deferrals to provide flexibility to struggling tenants.

We expect BHF's credit metrics will remain commensurate with the rating in a stress scenario but rating headroom remains tight. Our adjusted EBITDA figure for BHF is €13 million-€14 million in 2020, as result of a decline in rental income of 12%-14% (on a like-for-like basis). We expect rental income to rebound by around 9% in 2021. We estimate a contraction of 12%-14% for the retail segment and in the low teens for the office segment in 2020. We also anticipate the EBITDA coverage ratio to remain above 2.4x and the LTV ratio to peak at about 60%. These correspond with the weaker end of the range for our intermediate and significant financial risk categories. For BHF, deleveraging will mainly depend on EBITDA growth and, over the longer term, asset reappraisal.

BHF's liquidity profile is adequate. We anticipate that BHF's liquidity sources will cover uses by more than 1.2x over the next 12 months. We understand that BHF has no plans to dispose of or acquire any assets, and that the company has minor commitments to development projects. BHF's investors have approved management's plan to raise new equity during 2020, which would further strengthen the company's liquidity position.

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The consensus among health experts is that the pandemic may now be at, or near, its peak in some regions but will remain a threat until a vaccine or effective treatment is widely available, which may not occur until the second half of 2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Downside We could consider lowering our rating on BHF if the deterioration in rental income exceeds 11%-14% and cash flow results in EBITDA interest coverage falling below 2.4x. We would also view as negative an increase in speculative development activity or a debt-to-debt-plus-equity ratio exceeding 60%. This could occur if property valuations further deteriorate, if BHF suffers reduced access to equity funding for acquisitions or development, or implements a change in financial policy favoring higher leverage. The ratio of projected sources to uses of liquidity falling below 1.2x could also put pressure on the rating.

Upside We are unlikely to raise the rating in the near term. However, we could consider raising the rating if BHF were to increase its scale, thereby diminishing the potential exposure to operational risks related to individual properties and tenants, without compromising asset and tenant quality or occupancy rates. An upgrade would be also contingent on BHF achieving an LTV below 50% and EBITDA interest coverage of around 4x.

Company Description

BHF is a real estate fund and invests directly or indirectly in property located in Estonia, Latvia, and Lithuania. Its real estate assets are located in central and strategic areas of Baltic capital cities (Tallinn, Riga, and Vilnius) and comprise mainly fully developed premium office and retail properties, with high-quality tenants and low vacancies.

Related Criteria

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Mid-Market Evaluation Rating Methodology, Nov. 20, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.